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No. 03-128

Supreme Court, U.S.
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In The

Supreme Court of the United States

UNITED TECHNOLOGIES CORPORATION
PRATT & WHITNEY,
Petitioner,

v.

DONALD H. RUMSFELD, SECRETARY OF DEFENSE,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

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REPLY BRIEF FOR PETITIONER

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12 11

TABLE OF AUTHORITIES

Page

CASES

Arcadia v. Ohio Power Co., 498 U.S. 73 (1990) 1, 2
Cardinal Chem. Co. v. Morton Int'l Inc., 508 U.S. 83 (1993) 5
Clearfield Trust Co. v. United States, 318 U.S. 363 (1943) 7
Commissioner of Internal Revenue v. McCoy, 484 U.S. 3 (1987) 8
Cooke v. United States, 91 U.S. (1 Otto) 389 (1875) 3, 7
Kolstad v. American Dental Ass'n, 527 U.S. 526 (1999) 1, 2
Land v. Dollar, 330 U.S. 731 (1947) 5
Mazurek v. Armstrong, 520 U.S. 968 (1997) 5
Michael v. United States, 454 U.S. 950 (1981) 5
Mobil Oil Exploration & Prod. SE, Inc. v. United States, 530 U.S. 604 (2000) 3
Teague v. Lane, 489 U.S. 288 (1989) 1, 2
United States v. General Motors Corp., 323 U.S. 373 (1945) 5
United States v. Winstar Corp., 518 U.S. 839 (1996) 3, 6
Zacharin v. United States, 213 F.3d 1366 (Fed. Cir. 2000) 7, 8

STATUTES AND REGULATIONS

41 U.S.C. § 609(b) (1994) 9
48 C.F.R. § 30.202-6 (2003) 6
48 C.F.R. § 52.230-2 (2003) 6

OTHER AUTHORITY

Jacob A. Stein et al., *Administrative Law* § 15.02[4][g] (2003) 6

1. Without benefit of briefing or argument, the Federal Circuit ruled on a legal issue (a) not raised by the parties; (b) not decided by the tribunal below; and (c) not logically related to any question properly before the Federal Circuit.

Many decisions of this Court disapprove of the practice of deciding issues not briefed by the parties or decided by the courts below. The Government nonetheless asserts that while "appellate courts generally decide cases on the grounds advanced by the parties and avoid deciding issues not resolved by a lower court, ... there is no prohibition against addressing other issues *in an appropriate case*." (Br. in Op. 7.) (emphasis added). The Government then invokes three decisions of this Court in support of its view. Those three cases indeed highlight when it may be appropriate for an appellate court to decide an issue not briefed or addressed by the courts below—and when (as here) it is not.

In *Kolstad v. American Dental Ass'n*, 527 U.S. 526, 540 (1999), this Court decided an unbriefed issue (imputation of punitive damages liability to an employer) "intimately bound up" with the issue on review, and "easily subsumed within the question on which we granted certiorari."

In *Arcadia v. Ohio Power Co.*, 498 U.S. 73, 77 (1990), the Court did not reach the questions presented (whether SEC orders pre-empted conflicting actions by FERC in an area of overlapping jurisdiction) because it elected to decide an unbriefed "question antecedent to these and ultimately dispositive of the present dispute."

In *Teague v. Lane*, 489 U.S. 288, 299-300 (1989), the Court addressed the retroactivity of a new constitutional rule. The retroactivity question addressed by the Court was antecedent to the question on the merits because it bore

directly on whether petitioner had standing to raise the question it presented on the merits.[1]

Thus, as noted in our Petition (Pet. 15 n.4), appellate courts—including this Court—infrequently address an issue not argued by the parties, but only where (a) the issue is logically antecedent to issues that are briefed and argued (as in *Arcadia* and *Teague*); or (b) the issue is "intimately bound up" with the questions raised by the parties (as in *Kolstad*). In contrast, the Federal Circuit here reached out to proclaim a new rule on an issue (an affirmative defense) not necessary to disposition of the appeal and analytically distinct from the questions properly before it. While we cannot represent that such an action is unprecedented, it is not authorized by the cases of this Court.

The Government's permissive approach to the Federal Circuit's tack of issuing rules on issues not briefed by the parties nor decided below is, to say the least, surprising. Unfortunately, it is best explained by the financial benefits (at least $260 million in this case) that preserving the Federal Circuit's estoppel rule provides to the Government. This Court, in the exercise of its supervisory authority, may properly address such a matter—and ensure, at a minimum, that no such rule is adopted without briefing and argument—particularly where the new rule is inconsistent with this Court's own precedents.

2. The Federal Circuit's estoppel ruling is patently inconsistent with the many decisions of this Court holding that in performing its contracts, the Government is subject to the same legal standards applicable to contracts between

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[1] In *Teague*, the Court held that the Court could not reach the question presented because principles of non-retroactivity would bar relief to petitioner in the context of collateral review of a criminal conviction. *Teague v. Lane*, 489 U.S. at 299-301.

private parties, including equitable principles. *United States v. Winstar Corp.*, 518 U.S. 839 (1996); *Mobil Oil Exploration & Prod. SE, Inc. v. United States*, 530 U.S. 604 (2000). The "affirmative misconduct" rule which the panel prescribed in this contract case is limited by its rationale to cases where the government acts as sovereign. The rule has no application where the government is a contracting party, has waived immunity, has made decisions regarding contract performance through senior contracting officials acting within the scope of their specifically assigned decision-making authority, and has, in summary, stepped "down from its position of sovereignty and enter[ed] the domain of commerce." *Cooke v. United States*, 91 U.S. (1 Otto) 389, 398 (1875). The Government offers no persuasive reason why the Federal Circuit's peremptory and preemptive ruling, overturning more than a century of precedent and common understanding, should not be corrected—or at least considered—by this Court.

a. The Government asserts (Br. in Op. 6-7) that the petition should be denied because it is interlocutory and remand will allow further proceedings on "petitioner's estoppel defense."

This proposition understates the potentially limiting impact of the Federal Circuit's preemptive ruling on the scope of the proceedings and the Board's findings on remand. Only if the Court vacates the decision of the Federal Circuit would remand likely enhance the record for review of the question presented.

If the important questions presented by the petition are not reviewed now, they may escape review entirely.[2] It is by no

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[2] The first question presented would likely become moot, and escape review, if the Court denies the petition now. Yet that procedural issue requires the Court's supervisory attention particularly in light of the

means clear that this case will again come before this Court.[3] And if the estoppel issue does not come before the Court in this case, it is unlikely to be presented in any other. The Federal Circuit's jurisdiction over government contracting disputes is exclusive, and this new estoppel rule will become the authoritative standard in the administration of government contracts, notwithstanding its inconsistency with this Court's precedents. Faced with a clear edict that the "affirmative misconduct" standard must be met, few contractors would wish to incur the time and expense of challenging that standard in the lower courts and then pursuing a futile appeal to the Federal Circuit, just to preserve the ability to petition this Court for review. Thus, failure to grant certiorari here would allow the Federal Circuit's new estoppel standard to become the effective rule by default. That this rule has been created without benefit of briefing or argument even in the circuit court (let alone this Court) is not only unjust, but is clearly an improper way to create important legal rules.[4]

Government's position that this sort of *sua sponte* appellate ruling is unobjectionable. (Br. in Op. 7.)

[3] As with most cases, it is impossible to say that this case will not be resolved, whether by settlement or otherwise. The Government, of course, has a marked financial incentive to avoid this case reaching this Court again in order to shield the panel's estoppel rule from this Court's review. Even if this case were eventually to make its way back to the Court, tens of thousands of day-to-day disputes and contract interactions will remain subject to the Federal Circuit's ill-conceived ruling in the interim, undermining the ability of private contractors to rely upon the actions, instructions, and approvals of specifically authorized government contracting officials.

[4] This Court generally has the benefit of allowing issues to percolate among and through the various circuit courts. With respect to appeals from the Federal Circuit involving that court's exclusive jurisdiction, this Court's supervisory role is somewhat different. Although one benefit of

In any event, this Court's "cases make clear that there is no absolute bar to review of nonfinal judgments of the lower federal courts." *Mazurek v. Armstrong*, 520 U.S. 968, 975 (1997). The Court has explained that such review is appropriate where the court of appeal's decision is "clearly erroneous under our precedents" and "the lower court's judgment has produced immediate consequences." *Id. See also United States v. General Motors Corp.*, 323 U.S. 373, 377 (1945) (ruling at issue "fundamental to further conduct of the case"); *Land v. Dollar*, 330 U.S. 731, 734 n.2 (1947) (importance of question).[5] Certiorari is appropriate at this time in this case.

b. The Government does not contest the important practical impact of the Federal Circuit's ruling. That ruling, if left undisturbed, will directly affect the ability and willingness of government contractors to rely on the statements, actions, and approvals of federal contracting officials who are (as here) acting within the scope of their specifically assigned

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assigning exclusive jurisdiction over certain issues to the Federal Circuit was an ability to create nationally applicable precedent, that consideration does not militate against certiorari in a case like this. Where a new rule adopted by the Federal Circuit on an important issue is at best doubtful (as here) or inconsistent with this Court's precedents (as here) – and especially when such a rule has been announced without briefing or argument (as here) – the case is appropriate for review. Indeed, this Court has recognized the need for review because the Federal Circuit's rulings in areas within its exclusive jurisdiction are "of special importance to the entire Nation." *Cardinal Chem. Co. v. Morton Int'l Inc.*, 508 U.S. 83, 89 (1993).

[5] "Where there is an important and clear-cut issue of law which is fundamental to the further conduct of the case and which would otherwise qualify as a basis for certiorari, interlocutory status need not preclude review." *Michael v. United States*, 454 U.S. 950, 951-52 (1981) (White, J., dissenting from denial of certiorari).

authority, in the daily performance and administration of government contracts—of which there are approximately ten million outstanding at any given time. Jacob A. Stein et al., *Administrative Law* § 15.02[4][g] at 15-18 (2003).[6] The Federal Circuit's ruling that those government officials, unlike private parties, are *not* bound by their words and deeds, when those words and deeds are reasonably relied on by the parties with whom they contract, strikes at the core of the basic contractual relationship. *See Winstar*, 518 U.S. at 883 (1996) (citing "the Government's own long term interest as a reliable contracting partner").

The Government suggests that this Court's repeated admonition that, when the Government enters into contractual relations, it must perform and be judged on the same standards as private parties, is beside the point because that admonition did not specifically cover *estoppel*. (Br. in Op. 8.) This misreads the Court's precedents: Over the course of more than a century, this Court has adhered to a broad rule on the legal principles governing government contracts: they are the same as applied to private party contracts. That rule, on its face, covers this case.

The Government does not suggest that this Court has heretofore recognized *any* exceptions to that rule—let alone any exception into which the panel's "estoppel" ruling can be crammed. To the contrary, many of the historic foundations of the rule can be found in the application of the equitable doctrine of laches against the Government in a contract

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[6] In this case, the CAS provisions at issue were incorporated in Petitioner's government contracts as contractual terms. *See* 48 C.F.R. § 52.230-2 (2003). In approving Petitioner's disclosed accounting practices, the Government's contracting officers were acting within the explicit scope of their authority to administer contracts on behalf of the Government. 48 C.F.R. § 30.202-6 (2003).

setting—an issue closely related to the issue of estoppel. *See Cooke v. United States*, 91 U.S. (1 Otto) 389, 398 (1875); *Clearfield Trust Co. v. United States*, 318 U.S. 363, 369 (1943). Under the defense of laches, the Government is precluded from asserting its contractual rights by its silence and failure to timely act. Under the defense of estoppel, the Government is precluded from retroactively asserting its contractual rights when a contracting official, acting within the scope of his authority, took a contractual action on which the contractor relied. If anything, estoppel– which requires affirmative governmental *action*—should be easier to apply against the Government than laches, which rests on the Government's *inaction*.[7]

The Government ignores the inconsistency between the panel's holding and this Court's precedents. It says that this case presents merely "an asserted intra-circuit conflict." (Br. in Op. 9.) But the cases we cited from the Federal Circuit and its predecessor courts, extending over forty years, were not offered as an "intra-circuit" conflict. Those cases show that the estoppel rule the panel overturned *sub silentio* was well-understood, long-accepted, and long-relied upon.

Finally, the Government suggests (Br. in Op. 8-9) that the estoppel rule announced by the panel in this case had been ordained two years earlier in *Zacharin v. United States*, 213 F.3d 1366 (Fed. Cir. 2000), in which the affirmative misconduct standard was "applied in a patent case in which the government was acting in its proprietary capacity."[8] (Br.

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[7] Of course, the Federal Circuit considered none of this since it ruled without benefit of briefing or any evident consideration of these issues.

[8] The Government misleadingly invokes a "sovereign-proprietary" distinction, suggesting that Petitioner's position is linked somehow to a discarded concept of the Government acting in a "proprietary capacity." It is not. The rule on which we rely is as stated by this Court: It arises

in Op. 9.) But *Zacharin* was, as the Government concedes, a patent case—*i.e.*, not a contract case—in which the plaintiff sought damages from the Government for infringement of alleged patent rights. The case had nothing to do with the rights and remedies of the respective parties in connection with their performance of a government contract. In any event, a prior decision of the Federal Circuit cannot trump the precedents of this Court inconsistent with the Federal Circuit's *sua sponte* ruling.

The errors in the Federal Circuit's decision and its instruction regarding estoppel, the circumstances under which they were rendered, and their importance to the field of federal contracting militate alternatively for full consideration on the merits or summary disposition on the first two questions. *Cf. Commissioner of Internal Revenue v. McCoy*, 484 U.S. 3 (1987) (summary reversal warranted where disposition exceeded jurisdictional bounds).

3. With respect to the accounting issue, the Government asserts that "petitioner does not identify any specific terms that the court allegedly misconstrued" (Br. in Op. at 9), but the petition is clear that the misapplied term was "cost": That term should have been applied as *accountants* would interpret and apply the *accounting* standards of CAS, thus requiring examination of economic substance to determine whether the expenditures at issue were more like a purchase-sale, or more like a distribution to a stakeholder.

The Federal Circuit panel dispensed with both the relevant inquiry into economic substance and the Board of Contract Appeals' factual conclusions in applying that standard. While the Government characterizes the petition as turning on "specific facts," the issue is that the Federal Circuit cut off

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from the *contractual* relationship, not any concept of "proprietary capacity."

review of the Board's findings of fact and instead substituted a legal rule of its own creation, which it derived from the dictionary. Notably, the Government appears unwilling to defend the Federal Circuit's dictionary-definition approach to this accounting issue, choosing instead to argue that the Federal Circuit correctly distilled the economic substance. (Br. in Op. 10-11.) That was not, however, the basis for the Federal Circuit's ruling.[9]

The Government also asserts that inquiry into economic substance is "vague" and "depends on experts' judgments as to the 'substance' of a particular transaction." (Br. in Op. 11.) The Government (and the Federal Circuit) prefer a judicially-manufactured rule which, purportedly, will be easier to apply. But an appellate court is not free to impose a "simple rule" for simplicity's sake that is inconsistent with the basic nature of the business arrangements that must be accounted for. Such rules, divorced from consideration of the economic substance of particular transactions, are arbitrary and invite abuse, as recent accounting scandals have taught.

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[9] Nor could it have been the basis because the Federal Circuit never reviewed the Board's findings against the mandatory statutory standards, 41 U.S.C. § 609(b) (1994). Another illustration of the Government's and the Federal Circuit's total disregard of the Board's findings and their presumptive finality is their insinuation that petitioner recharacterized its financial accounting to make it consistent with its position in this dispute. (Br. in Op. 3, 5, 12.) The Board made a directly contrary finding based on substantial evidence. App. 87a ("auditors determined that it was preferable to report it as a reduction in revenue"); App. 105a ("Nothing in the record to suggest that the change was made for any other reason" than the "preferability letter"); App. 82a ("unsupported speculation"). Neither the Government nor the Federal Circuit reviewed this finding against the statutory standards, or even acknowledged the finding.

This case presents an issue that is important not merely for its financial effect in this and similar cases, but rather for the Federal Circuit's overreaching in seeking to impress simplistic legal rules upon the accounting standards of CAS, standards incorporated in millions of government contracts. CAS accounting impacts the business operations of many of the largest companies in the country. The issue whether companies can continue to account for their transactions as principles of accounting instruct them to do, according to the highest standards of the profession—*i.e.*, according to economic substance—is an important issue worthy of this Court's consideration.

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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